

# **Analysis of a New Business Division for a Building Supply Company**

by

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## **Abstract**

Dryco Building Supplies is a distributor of building supplies focusing mainly on drywall, steel and insulation. The company was founded in 1973 in Vancouver and over the last 40 years has expanded to 9 locations in 3 provinces. During this period Dryco has seen revenues grow to over \$80 million per year nationally, however the last 10 years has seen growth slow substantially. Dryco management is interested in opening a new business division offering a different line of products that target a new customer segment.

This paper analyses this attractiveness of this new business. It examines Dryco's current industry and compares it to the industry they are looking to enter. It then looks at how Dryco's current resources can benefit this new business. It compares Dryco's current strategies for growth versus the proposed strategy of entering a new industry. This includes financial projections and analysis. It evaluates the option of opening this new business versus other potential avenues for growth. Finally it gives a recommendation and implementation plan for the chosen option.

## **Dedication**

I would like to dedicate this project to my beautiful wife Christy and thank her for her support over the last 2 years. I would also like to thank my parents, Joan and Ken Boyce for encouraging me and supporting me through the duration of the program. Finally, I want to dedicate this paper to Maddie and Jackson who have inspired me to make something better of myself.

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# **1: INTRODUCTION TO DRYCO BUILDING SUPPLIES**

## **1.1 PURPOSE OF THIS SECTION**

This section presents a proposal put forth by the president of Dryco Building supplies. This is followed by a brief history of the company. The section culminates with an outline of how this proposal will be analyzed.

## **1.2 DRYCO BUILDING SUPPLY'S PROPOSAL**

The president of Dryco Building Supplies (the client) has requested an analysis be done on the feasibility of opening a new business. Dryco is a private company primarily owned by the Mauro family. It is controlled by a board of directors comprised of the company president, vice president, CFO and 3 members of the Mauro family. Any new venture requires the board's approval. The president believes a comprehensive assessment of this new business will aid in the board's decision-making process.

Dryco operates in a specific sector of the building supply industry that specializes in interior finishing products. Their product line includes drywall, insulation and light gauge steel framing. Companies in this sector are commonly referred to as Gypsum Specialty Dealers (GSDs). The majority of Dryco's business (approx. 90%) is done with interior finishing contractors that specialize in new construction. New construction is extremely cyclical and while it has been strong over most of the last 10 years, there is a concern that a downturn is approaching.

The client has recognized that it may be a wise decision to diversify Dryco's

customer base in order to protect against this downturn. The new business proposal presented by the client would be called Professional Renovation Contractors Supply (PRCS). This venture will focus on professional renovators. This is a customer segment that has largely been ignored by Dryco in the past. These renovators purchase product lines that Dryco does not currently offer. While PRCS would be run as a separate venture, it would use many of Dryco's existing resources to help minimize costs.

### **1.3 HISTORY OF DRYCO BUILDING SUPPLIES**

Dryco Building Supplies was founded in Vancouver, B.C in 1973 by 4 partners: Bruno Mauro, Vince Mauro, Gerry Malinka and Ken Kabush. From the outset their focus customer group was drywall contractors. The main product lines offered to these customers were drywall and drywall accessories. In the GSD industry, product is not only delivered to site, it also placed into the building in a specified location. Depending on type and length, drywall weighs between 50lbs to 130lbs per sheet and comes in bundles of two. Delivery crews are expected to carry up to 260lbs, sometime up a flight of stairs, in order to satisfy customer needs. The four partners agreed that by focusing on service instead of price they could differentiate themselves from the existing competitors in the industry. This strategy proved very successful and remains the backbone of the company's philosophy.

By the early 1980's Dryco realized their one location was at maximum capacity. This led to a 2<sup>nd</sup> store in Surrey being opened. The choice to open the new store in Surrey was made for two reasons. The first was to obtain a presence east of the Fraser River in order to capitalize on the growth expected to occur in the

suburbs. The delivery and yard staff at Dryco's Vancouver store belonging to a union was the second reason. Being part of a union was a necessity to get onto any jobsite in Vancouver in the early 1970's. This began to change in the early 1980's and the four partners agreed that opening a non-union location would reduce labour costs. The period following Expo 86 saw construction in the Lower Mainland skyrocket and by 1993 Dryco needed to expand once again. This time a new location was built in Langley B.C. The Langley location was twice the size of the existing Dryco shops and was designated to be the company's head office. Around that same time the partners decided it was necessary to bring in outside leadership if Dryco was to continue to grow. Terry Elliott, the CFO of one of Dryco's suppliers, was chosen to fill the newly created position of president. One of the conditions for acceptance of this position was that the 3 remaining partners, Bruno Mauro, Vince Mauro and Ken Kabush, would not interfere in day-to-day operations of the company. Under Terry's leadership Dryco expanded from 3 B.C. locations in 1993 to 10 locations nationwide by the time he retired in 2005. That expansion included 2 locations in Alberta and 4 in Ontario. Jim Ritchie, who is still president today, succeeded Terry. In 2004 Bruno Mauro bought out his brother Vince and Ken Kabush to become the primary shareholder in the company. Bruno is no longer involved in day-to-day operations; however, his two sons Daniel and Anthony are both members of the senior management team of the company, responsible for operations and marketing respectively.

From 2003 to 2012 revenues have fluctuated between \$75 and \$90 million per annum, tending to mirror new construction activity. This implies that Dryco's

growth has been fueled by industry growth. It also illustrates that Dryco is heavily exposed to a downturn in new construction.

## **1.4 ANALYSING DRYCO'S PROPOSAL**

In order to examine the client's proposal the remainder of this paper will be broken into 5 sections. Section 2 will perform an analysis of Dryco's current industry. Section 3 will examine the industry Dryco is proposing to enter with PRCS. Section 4 will focus on Dryco's internal characteristics and if they are compatible with this new business. Section 5 will look at Dryco's current and proposed strategic directions. Section 6 will perform an option analysis for Dryco's strategy going forward and result in a recommendation on which option best satisfies Dryco's needs.

## **1.5 SUMMARY**

This section introduced a proposal for a new business made by the president of Dryco Building Supplies. This was followed by a brief history of the company. This section concluded with an outline of how this proposal will be analyzed. The next section examines Dryco's current industry.

## **2: DRYCO'S CURRENT INDUSTRY**

### **2.1 PURPOSE OF THIS SECTION**

This section looks at Dryco Building Supplies current industry. The first sub-section of this analysis defines Dryco's current industry. The next sub-section looks at the relative strengths of the competitive forces affecting this industry using a framework developed by Michael Porter (2008). This is followed by a look at the political, economic, social and technological trends affecting Dryco's industry going forward. This section will conclude by determining if Dryco should consider entering a new industry.

### **2.2 DEFINITION OF THE GSD INDUSTRY**

For the purposes of this analysis we will narrow the scope to a specific sector within the building supply industry. As mentioned in section, Dryco competes in what is known as the gypsum specialty dealer (GSD) industry. Figure 2.1 shows the products with suppliers, competitors and customers within this industry.



**Figure 2.1:** Products with suppliers, competitors and customers within the GSD industry

Products with suppliers		Competitors (regions in brackets)	Customers segments
Drywall	<ul style="list-style-type: none"> <li>• CGC</li> <li>• Georgia Pacific</li> <li>• CertainTeed</li> </ul>	<ul style="list-style-type: none"> <li>• Winroc (national)</li> <li>• Dryco (national)</li> <li>• Pacific West (BC &amp; Alberta)</li> </ul>	<ul style="list-style-type: none"> <li>• Wall and Ceiling contractors specializing in new construction</li> </ul>
Steel	<ul style="list-style-type: none"> <li>• Bailey West</li> <li>• Steel form</li> </ul>	<ul style="list-style-type: none"> <li>• Kenroc (Western Canada)</li> </ul>	<ul style="list-style-type: none"> <li>• Renovators</li> </ul>
Acoustic panels	<ul style="list-style-type: none"> <li>• CGC</li> <li>• Armstrong</li> <li>• CertainTeed</li> </ul>	<ul style="list-style-type: none"> <li>• Commercial Construction Supply (BC &amp; Alberta)</li> </ul>	<ul style="list-style-type: none"> <li>• Builders &amp; General contractors</li> </ul>
Insulation	<ul style="list-style-type: none"> <li>• Johns Mansville</li> <li>• CertainTeed</li> <li>• Knauf</li> <li>• Owens Corning</li> </ul>	<ul style="list-style-type: none"> <li>• Patines (Ontario)</li> <li>• Watsons (Ontario)</li> <li>• Schumacher (Alberta)</li> </ul>	<ul style="list-style-type: none"> <li>• Do-it yourselves</li> </ul>

**Source:** Author

### 2.2.1 Products and suppliers for GSD industry

Companies within the GSD industry are distributors with a fairly narrow product line. GSD's sales come primarily from 4 product groups; drywall, steel, insulation and acoustic panels. All 4 of these lines are considered commodity products. There are limited suppliers to choose from for each of these product lines. This lack of choice means GSDs offer no differentiation on products. The recent economic slowdown in the United States has forced some supplier closures and consolidation. The weight and relatively low cost of these products make shipping them expensive. A cost effective shipping radius for most product lines carried by GSDs is less than 250 miles. This makes it difficult for GSDs to import materials from the United States where product costs are lower.

### **2.2.2 Competitors in the GSD industry**

Competitors in the GSD industry are regionalized. Only Dryco and Winroc have locations in both eastern and western Canada. High delivery costs force GSDs to have an operating branch within 200 miles of areas they wish to service. Different regions have different customer preferences. This has led to most GSDs staying close to their home province. Recent years have seen an increase in consolidation and acquisition within the industry. From 2006 to 2012 Winroc expanded from 30 to 44 locations across North America (Winroc.com, 2013). Winroc is now by far the largest firm in the industry. Dryco, Pacific West and Commercial Construction Supply each have between 8-11 branches across multiple provinces. Other competitors are smaller and more regionalized.

### **2.2.3 Customer segments within the GSD industry**

Figure 2.1 list 4 customer segments for the GSD industry. About 90% of sales for most GSDs come from the wall and ceiling contractor segment. This segment contains repeat customers who require between 100-1000 sheets of drywall per delivery. For most GSDs, 4 or 5 of these customers account for the majority of their sales. Each account has dedicated sales reps assigned to them. GSDs do not require contracts from customers when they award projects to the GSD. This allows customers to easily switch from one GSD to another. Thus, this segment is highly price sensitive.

The DIY customer segment accounts for close to 50% of the Canadian gypsum market. Big Box stores like The Home Depot serve the majority of this market. In order to target this market, money needs to be spent on marketing

campaigns and prime real estate for store locations. GSDs have not targeted this market due to these high acquisition costs for one-time customers.

Renovators and builders or general contractors use wall and ceiling contractors for their larger jobs. This segment accounts for a very small percentage of the overall market. Even for smaller jobs GSDs are reluctant to target them and bypass their main customer base.

## **2.3 COMPETITIVE ANALYSIS OF THE GSD INDUSTRY**

This sub-section looks at the strengths of the competitive forces that affect the GSD industry. In order to aid in this analysis we use a framework developed by Michael Porter (2008). This framework helps us determine the overall attractiveness of the GSD industry. Porter identified 5 forces that determine industry profitability. These forces are outlined in figure 2.2 and are rated as low, medium or high.

**Figure 2.2:** *Competitive forces affecting the GSD industry*



**Source:** Porter (2008) adapted by author

### **2.3.1 Competition between GSD's (rivalry) is medium to high**

Competition between GSDs is medium to high. GSDs are distributors selling similar products so they can only differentiate on service. GSDs face relatively high fixed costs in the form of leases, employees' salaries and depreciation. This leads to fierce competition as they compete to achieve scale. GSDs sales are closely linked to the cyclical new construction market so growth in this industry is cyclical as well. This leads to heavy price competition in periods of low growth (downturns in construction) and little price competition in times of high growth (upswings in

construction). GSDs generally compete fairly heavily on price. This, however, can be offset by differentiating on service and upturns in the economy.

### **2.3.2 Supplier bargaining power within the GSD industry is medium to high**

Supplier bargaining power within the GSD industry is medium to high. Most products purchased by GSDs are bought from suppliers that are highly concentrated. There are only 3 drywall suppliers and 4 insulation suppliers for all of Canada. For acoustic panels there are 3 suppliers in Canada and for steel there are 2. Supplier concentration increases supplier bargaining power within an industry. (Porter, 2008). With only a few GSDs per region, however, each has a fairly significant market share. This offsets some of the suppliers' bargaining power. The products offered by suppliers in this industry are relatively undifferentiated. This weakens supplier bargaining power within the industry. To combat this, suppliers have started focusing more effort on developing proprietary products.

### **2.3.3 Customer bargaining power within the GSD industry (buyer power) is high**

GSDs' customers have a high degree of bargaining power. GSDs compete mainly in the new construction market, selling to wall and ceiling contractors and ignoring DIYers. The majority of their sales (over 75%) come from their top 5 customers. This gives each of their customer's significant bargaining power. GSDs are distributors that essentially sell the same product. This means they can only differentiate on service. Customers can receive quotes from numerous suppliers easily and quickly. This makes information costs to buyers low. Finally, there are almost no switching costs for a contractor to switch from one GSD to another.

#### **2.3.4 Threat of substitutes to GSD's current product lines is low**

The threat of substitutes to the GSD industry is low. Plastered lath or concrete block wall construction are the 2 main substitutes for drywall. The cost and difficulty finding qualified labour for these techniques make them both poor substitutes. The two main substitutes for insulation are closed cell spray foam spray and insulated concrete forms. The high cost and a shortage of qualified labour for both these options make them poor substitutes as well. As the technology in these two processes improves costs will come down and they may pose threats in the future. For steel stud the possibility of using wood as a substitute is an option. The strength of this threat depends on the market price of raw steel vs. lumber. In concrete tilt up structures and high rises, however, wood is not a viable option. In these applications the installation of steel stud is quicker and easier than wood, leading to lower labour costs. For acoustic panels the main substitute is drywall, GSDs' core product. Another substitute increasing in popularity is an "open plan" ceiling. This is a design style where the underside of the roof in a commercial building is left exposed. While this has become more popular in recent years it is only a viable option in one-story buildings where there are no acoustical concerns.

### **2.3.5 Threat of new firms entering GSD industry is low**

The threat of new firms entering the GSD industry is low. The main barrier to entry for the GSD industry is the fact that the minimum efficient scale (MES) for operations is relatively high compared to the overall market size. The industry is scale intensive, with a GSD needing sales in the \$700,000 to \$1,000,000 per month in order to break even. Most Canadian markets can only support a few GSDs of this size. To open a new GSD is relatively capital intensive. It requires long-term leases, expensive delivery equipment and a full staff of delivery and sales personnel. There is typically a long sales cycle for acquiring a new customer, meaning equipment and staff will be idle for the first few months of operation. This makes it difficult for a new entrant to get into the market unless the overall market grows at a rapid pace.

In the past 20 years the only successful entrants have backwards integrated with large wall and ceiling contractors. This gave new firms immediate revenue in order to cover some of its costs while building up a complimentary customer base. There are few wall and ceiling contractors that are large enough to support an entire branch, making this a rare occurrence.

The final deterrent to entry is access to distributor channels. Suppliers to the GSD industry are reluctant to sell new entrants. This reluctance is due to the expectation that new entrants will compete heavily on price. This causes existing firms to pressure their suppliers to lower price to help compete.

## **2.4 TRENDS EXPECTED TO AFFECT THE GSD INDUSTRY**

This sub-section will look at the political, economic, social and technological trends influencing the GSD industry. We will examine how these trends affect the competitive forces described in sub-section 2.3

### **2.4.1 Political trends in the GSD industry**

Strong housing starts are critical to GSD industry growth. This makes government policy in regards to mortgages is an important factor for the GSD industry. Housing starts have been adversely affected from 2 recent policy changes. The first policy shift was the reduction in allowable amortization period from 35 to 25 years. The second was the increase of minimum down payment from 0 to 5 percent. It does not appear that the government will be making any significant changes to mortgage rules in the near future. If the government were to increase required down payment, or eliminate CMHC insurance, growth in this industry would suffer. Little or no industry growth increases rivalry between firms.

A second political factor influencing the industry is the increasing safety regulation required by provincial and federal safety boards. These regulations have forced GSDs to invest in the development of comprehensive safety programs. They have also forced GSD's to purchase new equipment allowing safer deliveries to sites. As governments continue to push for stricter safety policies fixed costs for GSDs will increase. This will makes entry into the industry more difficult due to the money and expertise needed to comply with these new regulations. The effect of these new regulations will benefit GSD's by increasing barriers to entry for potential competitors.



The enforcement of anti-dumping regulations on U.S. suppliers of drywall, steel and insulation could also affect the GSD industry. This would increase suppliers' bargaining power by eliminating GSDs' ability to import less expensive U.S. products.

#### **2.4.2 Economic factors influencing GSDs**

The GSD industry is heavily tied to new construction, making industry growth highly cyclical. Thus, the overall state of the economy is a major factor influencing the GSD industry. When economic growth is strong, construction growth tends to be strong as well. This leads to high growth rates in the GSD industry, reducing rivalry between competitors. The inevitable raising of interest rates will slow down the economy and new construction. GSD's should then expect competition between firms to increase.

The U.S. housing market's slow recovery is another factor that could affect the GSD industry in Canada. Low demand in the U.S. may force manufacturers to merge or shut their doors. A decrease in the number of suppliers would enhance the remaining suppliers' bargaining power on the GSD industry.

#### **2.4.3 Social trends and their effect on GSDs**

Over the last decade a social push for environmentally friendly building practices led to the establishment of LEEDs (Leadership in Energy and Environmental Design) certification. Projects seeking this certification are required to use the most environmentally friendly products possible. As the popularity of LEEDs grows GSDs will need to train and hire new staff to meet these requirements.

This will increase costs for GSDs but also increase barriers to entry into the industry.

The increasing popularity of “Do it yourself” projects is another social trend affecting the industry. These projects result in homeowners choosing to purchase materials themselves instead of going through professional contractors. Since the DIY market is small and fragmented, buyer power is reduced. Unfortunately, GSDs are currently poorly positioned to capture a large portion of this market.

### **2.3.4 How technology will affect the GSD industry**

There is little to no e-business being done by companies in the GSD industry. Most customers still rely on phoning or faxing in orders and quote requests. Developing a viable e-platform could help differentiate companies and reduce rivalry within the industry. Using improved software technology can help companies within the industry cut costs through better inventory control and data analytics. In order to acquire this software significant capital investment is required. This would raise barriers to entry, further reducing the threat of new entrants.

## **2.5 SUMMARY: THE GSD INDUSTRY – STABLE BUT LOW GROWTH**

The analysis in this section shows the GSD industry to be in a mature phase. The biggest threat to the GSD industry is a slowdown in new construction. While already a competitive industry, this competition has the potential for increasing. Rising interest rates or further changes to mortgage rules would worsen the expected slowdown in new construction. This would lead to the industry becoming

more rivalrous. GSD's face significant supplier bargaining power and the possibility of mergers or contraction could increase it even further. Increasing safety and environmental regulation will raise operating costs along with barriers to entry. Unfortunately, this is of little benefit as the threat of new entrants is already low. The low threat of entry and substitutes keeps this industry stable. The industry as a whole, however, will see low growth in revenue and profitability in the near future.

Firms wishing to exceed industry growth will need to do so using competitive advantage through differentiation or cost advantage (Boardman, Shapiro and Vining, 2004, pg. 18). GSDs distribute commodity products from a limited number of suppliers. This means they can only differentiate on service. Operating a GSD as low cost will usually negatively affect service levels. Operating a GSD as high service will usually increase costs. This paradox will make it difficult for Dryco, or any other GSD, to obtain a significant competitive advantage.

## **2.6 CONCLUSION: DRYCO SHOULD STAY IN GSD INDUSTRY, BUT NEEDS TO FIND NEW AVENUES FOR GROWTH**

The analysis done in this section paints the GSD industry as an unattractive one. Dryco, however, has no desire to exit this industry. Dryco currently enjoy a healthy market share in the majority of their regions with sales of over \$85 million in 2012. Dryco made approximately \$4 million EBITA in 2012, a return on sales (ROS) of around 5%. This business continues to generate significant cash flow for Dryco's owners.

The GSD industry is a mature one, and therefore growth levels are expected to be low. While Dryco will continue to operate within the GSD industry, new

strategies for growth are needed. The avenue proposed by the client to open a business focused on professional renovation contractors. The next section will look at the attractiveness of this new business' industry.

## 3: A NEW INDUSTRY FOR DRYCO?

### 3.1 PURPOSE OF THIS SECTION

This section shifts the focus from Dryco's current industry to the industry the proposed new business would compete within. The first sub-section outlines the new business Dryco is proposing. The next sub-section defines the new industry Dryco is proposing to enter. This sub-section looks at the customers; suppliers and competitors for each product line the new business is proposing offer. This is followed by a competitive forces analysis on this industry. The final portion of this section will determine the attractiveness of this new industry.

### 3.2 THE NEW BUSINESS

#### 3.2.1 Why enter a new business?

Section 1 presented the idea of Dryco Building Supplies starting a new business. There are two reasons the client is interested in a new business outside the GSD industry:

1. Revenue growth: Dryco has significant market share in the GSD industry.

This industry is expected to experience little growth. It is difficult to differentiate within the GSD industry. These factors will make revenue growth for Dryco, within the GSD industry, difficult.

2. Protect Dryco against the cyclical nature of new construction: Over 90% of Dryco's revenues are from contractors in new construction. Dryco is heavily exposed to any downturn in new construction.

Section 2 showed Dryco's biggest threat to be an economic downturn. Close to 90% of Dryco's revenue is generated by sales to contractors in new construction. Dryco is extremely vulnerable to any event that could slow down new construction. Such events include; recession, government regulation on mortgages, changes to CMHC insurance and higher interest rates. New construction in Canada is expected to at best remain flat and may decrease over the next two years. (RBC provincial outlook, 2013) The worst-case scenario is a housing crash similar to the 2008 U.S. meltdown.

### **3.2.2 Professional Renovation Contractor Supply (PRCS)**

The client proposes a business focused on professional renovation contractors. The client has named this business Professional Renovation Contractor Supply (PRCS). This business would specifically target contractors that deal with exterior renovations. PRCS would give Dryco access to an entirely new customer base. Additionally, customers to PRCS would purchase products that are not currently offered by Dryco. This customer segment operates within the renovation sector as opposed to new construction one. The client feels that this business presents a good opportunity for Dryco. The business can both grow revenue and mitigate the risk of a downturn in new construction.

Dryco's current industry focuses on interior finishing products such as drywall, steel stud and insulation. A new business focusing on exterior renovators would offer a completely different product line, one in which Dryco has almost no market share.

### **3.2.3 PRCS's product line**

For the proposed new business Dryco would specialize in the following products:

#### **3.2.3.1 Specialty windows and doors**

Dryco has secured a line of high-end windows and doors that could be marketed to both renovators as well as high-end homebuilders. The supplier also offers lower end "commodity windows". The client, however, feels this market is already saturated and has no interest in offering them at this time

#### **3.2.3.2 Residential roofing**

Dryco currently has 2 locations that are selling residential roofing shingles and accessories. These locations are focusing solely on roofing contractors involved in new construction. The client would like to expand this offering to focus more on the higher margin professional renovator customer segment.

#### **3.2.3.3 Residential siding**

Dryco has no relationships with suppliers of this product; thus, the client feels this is the most difficult market to enter. It is a vital component, however, if PRCS is to offer a complete exterior package. PRCS will offer cementitious siding and backer boards. The client has no interest in offering other types of siding materials.

#### **3.2.3.4 Other potential products**

Other products commonly used by exterior renovators include decking, plywood and lumber. Lumberyards currently offer these products. The client has no desire to compete in the lumber industry.

#### **3.2.4 Footprint of the new business**

Considering Dryco's national footprint, the client is currently looking to operate the new business in B.C., Alberta and Ontario. In B.C. and Ontario there would be one branch per province co-located with the new business. In Alberta, the client would eventually like to see the business in both Edmonton and Calgary.

### **3.3 DEFINING PRCS' INDUSTRY**

PRCS's industry is difficult to define. Numerous different firms, from different industries, distribute the products the proposed business would offer. In order to help define the industry we look at the customers, suppliers and competitors for each of the products listed in section 3.2. We then assemble that information to conduct a competitive forces analysis. This will help gauge how attractive this new industry is.

#### **3.3.1 Specialty windows and doors – suppliers, competitors & customers**

The client's intent is to sell high-end custom windows and doors. Figure 3.1 shows the relevant suppliers, competitors and customers. Dryco's chosen supplier is listed in bold. The supplier list in this table is significantly smaller than one for the entire Window and Door industry due to the focus on high-end custom products.



**Figure 3.1:** Suppliers, competitors and customer segments for specialty windows and doors

Suppliers *	Competitors (region in brackets)	Customer segments
<ul style="list-style-type: none"> <li>• All Weather Windows</li> <li>• Armour Windows and Doors</li> <li>• Gentek</li> <li>• Jeldwen Windows and Doors</li> <li>• Plygem Building Products</li> <li>• KV Custom Windows and doors</li> <li>• Hometech Window corp.</li> <li>• <b>Koltech Windows and Entrance Systems</b></li> <li>• (16 other companies are part of Window Wise program)</li> </ul>	<ul style="list-style-type: none"> <li>• Longlife Windows &amp; Doors (B.C.)</li> <li>• Canadian Choice Windows (ONT)</li> <li>• Gem Windows (ONT)</li> <li>• Windowland (ONT)</li> <li>• E.T. Windows (Calgary)</li> <li>• Lincoln Windows (Calgary)</li> <li>• Rusco (Calgary)</li> <li>• Home Depot (national)</li> <li>• Rona (National)</li> <li>• Windsor Plywood and Doors (B.C., AB)</li> </ul>	<ul style="list-style-type: none"> <li>• Home owners</li> <li>• Professional renovators</li> <li>• Custom home builders</li> <li>• Restoration companies</li> <li>• Spec home builders</li> </ul>

**Source: Author**

**\*All suppliers' part of Window wise program**

### **3.3.1.1 Suppliers of specialty windows and doors**

The Window wise certification program was chosen as the sample group of suppliers. Window wise is a certification program focused on window replacement, not on new construction. 8 of the 24 window wise suppliers are listed in the table above. As of 2012 there are over 2000 other Canadian window manufacturers (windowwise.com, 2013). This is very different from the GSD industry. Suppliers to

the GSD industry are heavily concentrated with only a few manufacturers per product line.

Another difference between industries is that suppliers to the GSD industry sell commoditized products. Window manufacturers differentiate on quality and design, allowing them to compete on more than just price.

#### **3.3.1.2 Distributors of specialty windows and doors**

Figure 3.1 lists only a handful of the distributors that sell windows and doors. These distributors range from small regional firms to multinationals like The Home Depot. Differentiation of product limits price competition among firms. Many windows and doors distributors also differentiate with installation services. Finally, many distributors specialize only in windows and doors. This may offer PRCS an advantage in economies of scale and scope.

#### **3.3.1.3 Purchasers of specialty windows and doors**

Professional renovators are small to medium sized customers with low purchasing power. Conversely, large spec homebuilders can command significant volume discounts. Distributors focused on renovators do not have one or two “anchor accounts”, instead needing a broad customer base. This leads to higher customer acquisition costs than in the GSD industry. Installation services are necessary for direct sales to homeowners. PRCS needs to either add this service or forgo the homeowner customer segment.

### 3.3.2 Residential roofing – suppliers, competitors & customers

Dryco currently sells residential roofing in the Calgary and Barrie market.

Figure 3.2 shows the suppliers, competitors and customers for the entire Canadian residential roofing market.

**Figure 3.2:** *Suppliers, competitors and customer segments for residential roofing market*

Suppliers	Competitors	Customers
Iko	Convoy	Roofing contractors
BP	Roofmart	Renovators
CertainTeed	Proline (BC)	Home owners
GAF	Consolidated Gypsum (AB)	
	Winroc (BC, AB)	
	Home Depot	
	Local lumber yards	

**Source:** Author

#### 3.3.2.1 Suppliers of residential roofing

The supplier situation for roofing is much different than that of windows and doors. Suppliers of asphalt shingles are highly concentrated, similar to those in the GSD industry. This gives suppliers in this industry a significant amount of bargaining power. This bargaining power is somewhat mitigated by the fact that asphalt shingles have been commoditized.

Supplier's pricing to distributors is volume dependent. A truckload of asphalt shingles is worth approximately \$10,000. Distributors must order 60-100 truckloads at a time in order to receive the best price. Suppliers schedule the truckloads to ship based on their plant production schedules.

### **3.3.2.2 Distributors of residential roofing**

Competition in the residential roofing is different than in the windows and doors sector. A few large firms, notable Convoy and Roofmart, supply the majority of the market. Two GSD's (Winroc and Consolidated) have made a successful leap in to the roofing business, although this has been regional. Local lumberyards also supply residential roofing. Lack of product differentiation and the number of competitors make this business extremely rivalrous.

### **3.3.2.3 Purchasers of residential roofing**

Roofing contractors are the main customer segment for residential roofing. These contractors are large and have significant buying power. The renovator market is made up of a number of smaller firms. PRCS hopes to sell to this underserved segment that has less buyer power. This strategy of targeting underserved accounts to grow roofing sales has been successful for Dryco at their Calgary and Barrie locations.

### **3.3.3 Residential siding – suppliers, competitors and customers**

Dryco has no experience or established relationships in this product line. As mentioned in sub-section 3.2.3.3 PRCS will only offer cementitious siding. Figure 3.3 lists the suppliers, competitors and customers for cementitious residential siding.

**Figure 3.3:** Suppliers, competitors and customer segments for cementitious siding market

Suppliers	Competitors	Customers
James Hardie	Convoy	Siding contractors
CertainTeed	Proline	Home Builders
Maxtile	Roofmart	Home owners
Nichiha	Local Lumber yards	Renovators
	Home Depot	
	Rona	

Source: Author

### 3.3.3.1 Suppliers of cementitious siding

Like roofing, cementitious siding is dominated by a few manufacturers. While figure 3.3 lists 4 suppliers, only James Hardie and CertainTeed have a significant presence in Canada. Suppliers differentiate their products by offering a variety of styles and colours. A limited number of suppliers combined with differentiated products give cementitious siding suppliers a high degree of bargaining power.

### 3.3.3.2 Distributors of cementitious siding

Many roofing distributors also distribute cementitious siding. Convoy and Roofmart sell nationally; however, many lumberyards offer the products as well. There is little differentiation on product since each distributor sells one of two manufacturers' products. Any company with a flat deck truck can do deliveries. This makes differentiation on service difficult. The only way a distributor can differentiate is on selection of products. There are a wide array of styles and colours offered by each manufacturer. A distributor with a wide selection can supply

products quicker than competitors. This requires distributors to make a significant commitment in terms money and space, creating a barrier to entry.

### **3.3.3.3 Purchasers of cementitious siding**

The majority of cementitious siding is sold for new construction. Therefore, the main customer segments are homebuilders and siding contractors. There is, however, a growing market for this product within the renovators segment. As people upgrade their older homes from vinyl siding and stucco, the more modern look of cementitious siding is becoming popular. This product is also used to replace cracked and rotten wooden siding. Currently, distributors of cementitious siding do not focus on renovators, creating an opportunity for PRCS. Initially, PRCS may need to purchase material from another distributor to enter this market. This would allow the company access to a variety of styles and colours without the carrying costs.

### **3.3.4 How do these product lines fit together?**

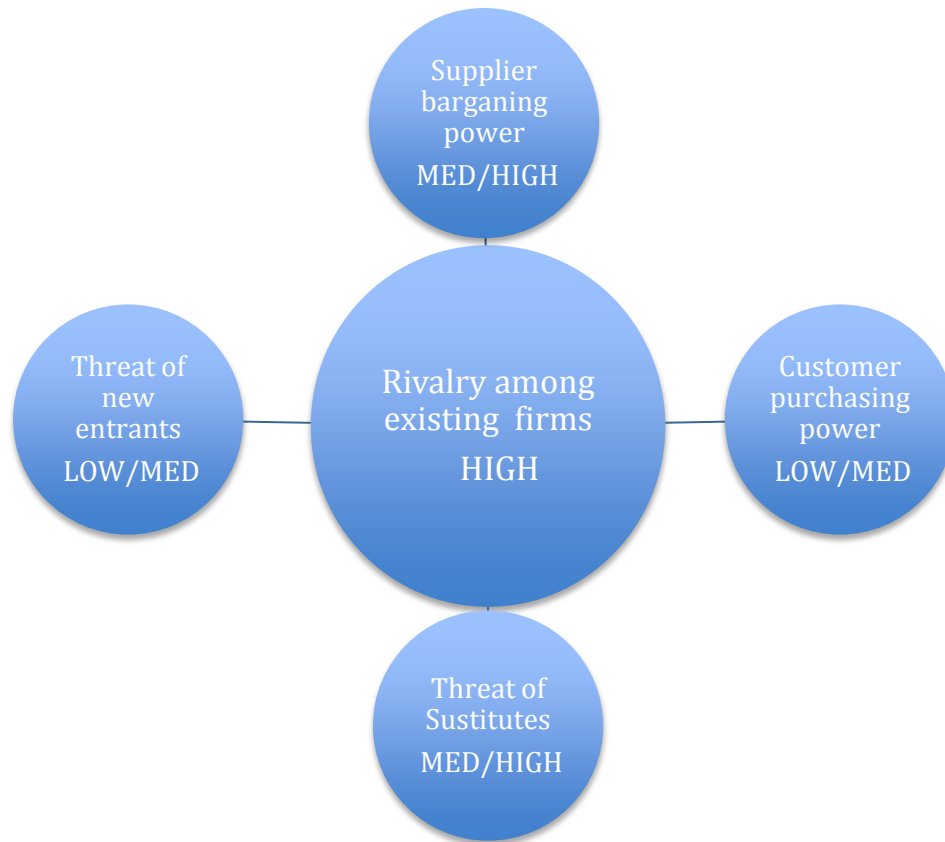
Looking at PRCS' proposed product lines give us an idea of what this industry looks like. Numerous firms already carry both roofing and cementitious siding. Manufacturers of these products are highly concentrated, similar to the GSD industry. Large distributors such as Convoy and Roofmart focus much of their attention on contractors and homebuilders specializing in new construction. Conversely, there are over 2000 window and door manufactures in Canada alone. There are a number of small regional suppliers, many of whom install the products themselves. While some of these suppliers focus on new construction, many focus on the renovation market.

The boundaries of this industry are blurry. Big box stores, like the Home Depot, are the only competitors carrying the full product line PRCS is proposing. The customer segment the big box stores focus on, however, is homeowners. The next sub-section performs a competitive analysis of this new industry. This analysis determines the attractiveness of this industry.

### **3.4 COMPETITIVE ANALYSIS OF PRCS' INDUSTRY**

“Industry structure drives competition and profitability, not whether an industry is emerging or mature, high tech or low tech, regulated or unregulated.” (Porter 2008, pg. 81). This sub-section uses the same framework used to analyze the GSD industry in section 2. Figure 3.4 show the 5 competitive forces influencing an industry's attractiveness (Porter 2008). The forces are rated as low, medium or high.

**Figure 3.4:** *Competitive forces affecting PRCS's industry*



**Source:** Porter (2008) adapted by author

### **3.4.1 Competition between firms in this industry (rivalry) is high**

Rivalry in this industry is high. The number of competitors, lack of differentiation and industry growth are factors affecting rivalry.

#### **3.4.1.1 There are a many competitors in all product lines.**

Convoy and Roofmart have dominant market shares in roofing and siding. Local lumberyards also distribute these products. There are hundreds of distributors of windows and doors within Canada. Many distributors competing for a share of a fixed market increase rivalry (Porter, 2008).



#### **3.4.1.2 Lack of differentiation**

Distributors cannot differentiate with roofing or siding due to the limited choice of suppliers. Without differentiation firms are forced to compete on price. Windows and doors, however, are differentiated on style and quality. This helps mitigate some rivalry within the industry.

#### **3.4.1.3 Industry is low growth**

Annual renovation spending in Canada has been relatively flat over the last few years. Low growth causes competitors to compete on price for market share. This is especially true for roofing, which has become commoditized.

### **3.4.2. Threat of new firms entering this industry is low to medium**

There is a low to medium threat of entry into this industry. Economies of scale, capital requirements and access to distribution channels raise entry barriers for this industry. Economies of scope make entry less difficult.

#### **3.4.2.1 Industry is scale intensive**

Roofing and siding take up a large amount of space, requiring a distributor to have a large warehouse and yard. Trucks, delivery staff and yard personnel are also required in order to distribute these products. This combination leads to high fixed costs. There is a long sales cycle for acquiring new accounts. Thus, initial revenues are small compared to the expenses of running a yard.

#### **3.4.2.2 Industry is capital intensive**

For roofing and siding there is a significant investment in inventory required. Roofing distributors order \$600,000 to \$1,000,000 of product at a time in order to receive the maximum volume discount. The James Hardie cementitious siding

product Hardieplank comes in 3 different styles, each with 4 widths available. There are 24 colour choices per style and width. (JamesHardie.com, 2013) A distributor must carry 288 products, about \$300,000 worth of product, in order to stock all styles, widths and colours. . Conversely, windows and doors are made to order, requiring no inventory. The only space requirement for this product line is a small showroom. In order to stock all product lines a new entrant requires significant financial backing. Low margins on these product lines deter potential entrants from making this investment.

#### **3.4.2.3 Access to distribution channels is limited**

Suppliers to this industry limit the number of distributors per region. For roofing and siding there are only 2 or 3 suppliers for the Canadian market. As in the GSD industry, these suppliers are reluctant to alienate existing customers by selling to new entrants. Windows and door suppliers usually have only one or two distributors per region. This is done to avoid having competing distributors drive down the price of their product.

#### **3.4.2.4 Economies of scope make entry possible**

Many distributors of the product lines in this industry also sell a variety of other products. Local lumberyards are able to use existing space and delivery equipment to service roofing and siding customers. This mitigates the industry's economies of scale.

### **3.4.3 Supplier bargaining power within the industry is medium to high**

Supplier bargaining power within this industry is medium to high.

Oligopolistic suppliers, differentiated products and high switching costs are factors affecting supplier bargaining power.

#### **3.4.3.1 Suppliers to industry are highly concentrated**

Roofing and siding each have only a few major suppliers within Canada. BP and Iko are the only members of the Canadian Asphalt Shingle Manufacturers Association (CASMA). This suggests some levels of tacit collusion. James Hardie and CertainTeed are the only two cementitious siding companies operating in Canada. Lack of choice for distributors gives suppliers of these product lines significant bargaining power. Window and door manufacturers are much more fragmented. This reduces some of the supplier bargaining power within the industry.

#### **3.4.3.2 Siding, windows and doors can be differentiated**

Cementitious siding is offered in over 250 different styles. This makes an “apple to apple” comparison between James Hardie and CertainTeed’s product lines difficult. There are over 2000 windows manufacturers in Canada. The quality of product of each varies a great deal. Suppliers of windows and doors with a reputation for quality can demand premium prices. Asphalt roofing is relatively commoditized. This mitigates some supplier bargaining power.

#### **3.4.3.3 Industry has high switching costs**

Window and door manufacturers require distributors to sign multi-year distribution contracts. Breaking these contracts can be costly. James Hardie and

CertainTeed's sidings are differentiated and cannot be mixed and matched. Once a distributor has taken a large inventory position with either one it is difficult to switch. Roofing shingles are undifferentiated making switching costs for this product low. This offsets some supplier bargaining power.

### **3.4.4 Customer purchasing power is low to medium**

Purchasing power for the customer segment targeted by this industry is low to medium. Customer size and switching costs are the factors affecting buyer's power.

#### **3.4.4.1 Small to medium sized customers**

This industry focuses on professional renovators. This segment is comprised of smaller, more fragmented firms. Unlike the GSD industry, firms within this industry do not have one or two large anchor accounts. This gives customers less leverage when negotiating price.

#### **3.4.4.2 Low switching costs for buyers**

Both roofing and siding have only two major suppliers within Canada. Each supplier has numerous distributors carrying their products. Contractors can therefore purchase the same material from a number of different distributors. Contracts between distributors and contractors are rare. This makes switching costs low for customers in this industry, thus increasing their purchasing power.

### **3.4.5 Threat of substitutes is medium to high**

The threat of substitutes in this industry is medium to high. Both asphalt shingles and cementitious siding were developed as substitutes for similar wood based products. Cedar shingles are still a viable substitute for asphalt ones. Steel

roofs are also becoming popular in some regions. Cementitious siding has a number of substitutes as well. Vinyl siding and stucco are lower cost alternatives. Steel and aluminum siding are increasing in popularity, although they are more expensive.

There are currently no substitutes for windows or doors. Commodity windows and doors, however, are substitutes for custom ones.

### **3.5 IS THIS AN ATTRACTIVE INDUSTRY?**

#### **3.5.1 Industry conclusion**

At first glance this industry does not appear much better than Dryco's current one. High rivalry and supplier bargaining power would suggest margins in the industry are low. Conversely, customer purchasing power in this industry is relatively low. This could alleviate some of the pressures on margin from suppliers and competitors. There is a relatively high threat posed by substitutes. The extent of this threat depends largely on the price of these substitutes. Barriers to entry in this industry are relatively high. While this is good for firms within the industry, it is a negative for potential new entrants. The combination of these factors indicates that industry growth is low. In order for a firm to succeed in this industry it will need to do so by competitive advantage.

#### **3.5.2 Does entering this industry make sense for Dryco?**

Dryco's has the infrastructure in place for a national distribution business. Using their existing yards and delivery staff can effectively eliminate one a barrier to entry using economies of scope. Dryco is already selling roofing in Calgary and Barrie. This experience would be an asset for the new business. Dryco has a strong relationship with CertainTeed's drywall and insulation division. They can attempt

to leverage this relationship to strengthen their negotiating position on siding and roofing. Dryco has secured distribution of a custom window line from a company with few other distributors in Dryco's regions. As of February 2013 this line was being trialed in Ontario. Dryco needs to make its decision with the realization that this new business may boost revenues but margins will be slim.

### **3.6 SUMMARY – NEW INDUSTRY LOOKS A LOT LIKE DRYCO'S CURRENT ONE.**

This section focused on a new business proposed by Dryco's president. This business would be called Professional Renovation Contractors Supply (PRCS) and focus on the professional renovator customer segment. This section looked at suppliers, competitors and customers in each of the product lines this new business would carry. This allowed us to define and analyze PRCS' industry. This industry analysis highlighted many similarities between this business and Dryco's current one. These similarities include: concentrated suppliers, relatively high rivalry and relatively low threat of entry. Lower buyer purchasing power and higher threat of substitutes are the main differences between PRCS' and Dryco's industries.

The next section examines Dryco's internal resources and their compatibility with this new industry.

## **4: INTERNAL CHARACTERISTICS OF DRYCO BUILDING SUPPLIES**

### **4.1 PURPOSE OF THIS SECTION**

This section moves away from industry analysis and looks at Dryco's internal characteristics. This section is separated into 3 sub-sections. The first sub-section examines Dryco's current resources. The 2<sup>nd</sup> sub-section looks at Dryco's organizational structure. The final sub-section will look at how Dryco can add value, (i.e. generate revenue) in the industry proposed in section 3.

### **4.2 DRYCO'S RESOURCES**

This sub-section looks at Dryco's resources separated by functional types. These resources include: financial, fixed assets, human resources, intangible and technical resources.

#### **4.2.1 Financial resources**

Dryco's September 2012 financial statements (appendix 4.1) show approx \$2.6 million dollars in short term debt. This leaves \$7.4 million of a \$10 million line of credit available. Dryco has over \$10 million in accounts receivable and \$3 million in inventory as of September 2012. Accounts payable and accrued liabilities account for almost \$5.5 million. Dryco has no long-term debt on their balance sheet. Dryco's debt equity ratio is 1.05 and their current ratio is 1.78. Dryco's balance sheet shows a company in a stable position. Dryco has access to significant funds and has no long-term obligations. This allows them to take on the additional risk of entering a new business without putting them in a tenuous financial position.

## **4.2.2 Fixed assets**

Dryco's September 2012 financials show approximately \$1.4 million in fixed assets. The majority of this is delivery and warehouse equipment, including trucks, cranes, forklifts and trailers. The balance of the assets is office equipment and computer hardware. Dryco does not own the property or buildings where their branches are located. Mauro management Group owns 7 of the 9 building on these properties. Bruno Mauro owns this company.

## **4.2.3 Dryco's human resources**

### **4.2.3.1 Senior management**

Dryco's senior management team is comprised of President-Jim Ritchie, Vice President -Darren Joyce, National Marketing Manager - Anthony Mauro and National Operations Manager-Dan Mauro. The primary owner, Bruno Mauro, is chairman of the board of directors but not active in the day-to-day operations of the company. Glenn Gordon, Dryco's senior controller, oversees the accounting and finance departments.

The Dryco management team has been stable since 2005 when former president Terry Elliott retired. Jim Ritchie was formerly employed by Synkoloid Canada as president. Mr. Ritchie was also the majority owner of Synkoloid. He was responsible for Synkoloid's growth from a small start up to the leading manufacturer of drywall compound in Western Canada. His career culminated with Synkoloid when he engineered the sale of the company to CGC inc., the largest drywall manufacturer in Canada. Jim Ritchie has established extensive contacts



throughout the building supply industry. He also has strong relationships strong with many building material manufacturers across North America.

Darren Joyce has been with Dryco since the early 1990's, working his way up from a junior inside sales position to the Vice President. He also has extensive contacts in the building supply and manufacturing industries.

Dan and Anthony Mauro have been in their positions 7 and 8 years respectively. As Bruno Mauro's two sons they have grown up with Dryco and possess extreme loyalty and pride towards the company.

#### **4.2.3.2 Middle management**

Dryco's national footprint forces the company to rely on their middle management team to handle day-to-day operations. Each branch has a manager who is directly responsible for their branch's profit and loss. In Alberta and Ontario, branch managers report to a regional General Manager. In B.C., branch managers report directly to Dan Mauro. The average age of a Branch manager is currently less than 40 years old. Most managers are eager to succeed and promote further within the company. The lack of senior management positions, however, has meant not much administrative movement over the last 7 years. Dryco has a group of eager and skilled individuals capable of moving new business opportunities forward. If Dryco does not come up with these opportunities, there is a significant risk of losing managers to competitors or other industries.

#### **4.2.3.3 Accounting services**

Since 2005, Dryco has performed the majority of their accounting functions within their Langley head office. This centralization allows Dryco to handle the

accounting functions for new locations or new product lines relatively easily. This service is billed out to each branch at a rate based on the branches percentage of overall company sales.

#### **4.2.3.4 Sales force and sales management**

Dryco's sales force operates differently in each region. Each Dryco location has at least one salesman. Salesmen in B.C. report to the B.C. sales manager, Derrick Gray. Salesmen in Alberta and Ontario report directly to their branch manager. Dryco also has a Western Canadian Acoustic Sales Manager who handles tile, grid and other acoustical products in B.C. and Alberta. Dryco has recently added a building envelope group. This group's sales manager is located at the Langley head office. Other than these two groups, most salesmen focus on traditional GSD customers. Dryco does, however, have salesmen in the Calgary and Barrie branches focused on roofing.

In the past, Dryco has had a difficult time in trying to sell new product lines with their existing sales force. In 2006 Dryco entered the manufactured stone market by obtaining a distributorship for a Malaysian product called Craftstone. Dryco's inability to sell this product with the company's existing sales staff forced it to be liquidated at auction in 2011.

#### **4.2.3.5 Operational staff**

The majority of Dryco's employees are considered operational staff. This includes delivery drivers, yardmen and inside sales staff. Drywall delivery is a labour intensive process. It typically takes 2 men 1-2 hours per delivery to unload material from the truck into the building. Drive time must also be considered. Each

branch employs between 8-20 delivery staff and another 2-7 yard staff. Delivery and yard staff is typically paid by the hour. In some provinces, Dryco uses piecework bonuses to increase productivity of these personnel. The need for a minimum staffing level regardless of branch revenues make yard and delivery wages somewhat scale intensive. The cost of inside sale staff is scale intensive as these are typically salaried positions.

#### **4.2.4 Intangible assets**

The Financial Accounting Standards Board Accounting Standard Codification 350 (ASC 350) defines an intangible asset as “an asset, other than a financial asset, that lacks physical substance” (Wikipedia.org). Dryco has two intangible assets. The first is its brand within the construction industry. Dryco has been in operation since 1973 and has developed a reputation as a reputable building supply company offering high levels of service. This is particularly true in the B.C. region where Dryco was founded.

Dryco’s other intangible asset is their national distribution capability. Their locations in most major Canadian markets allow Dryco to ship and distribute products from B.C. to Ontario. Many of these locations have unused capacity. This presents an opportunity to capitalize on economies of scale and scope.

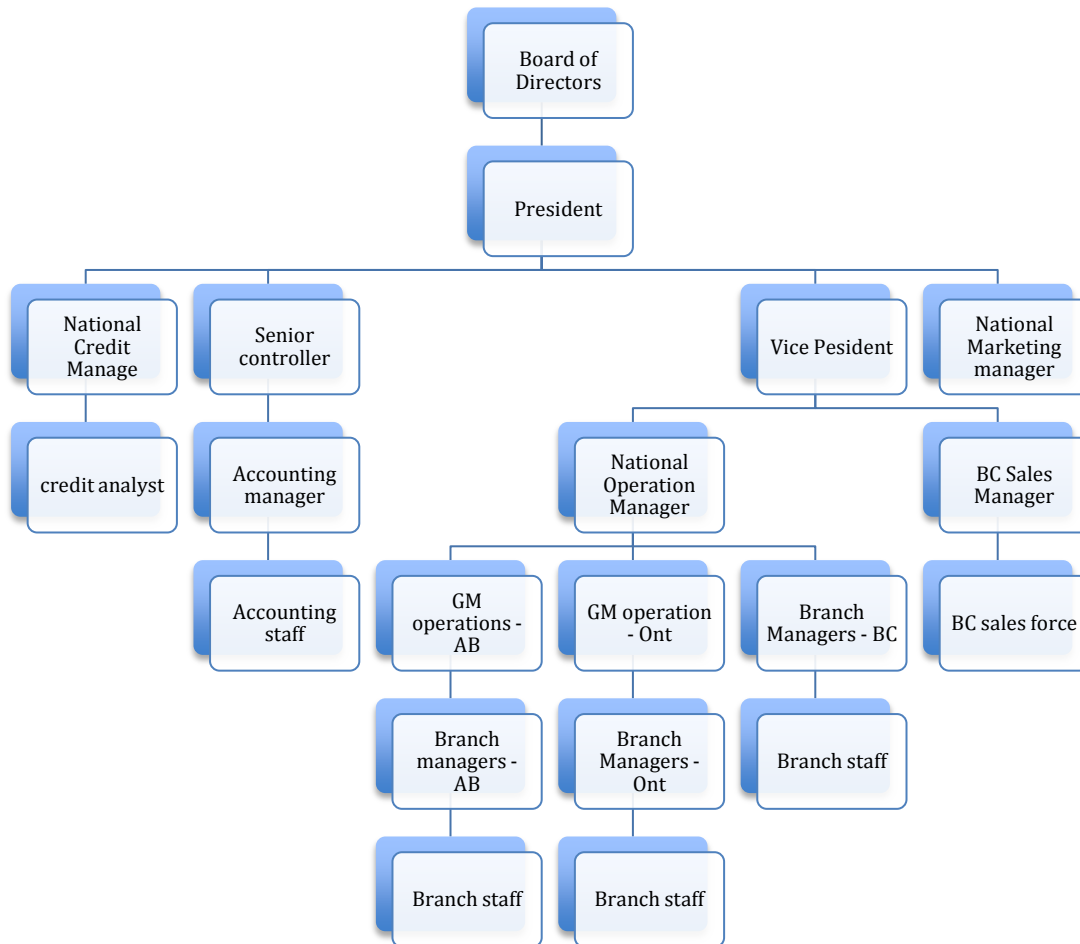
#### **4.2.5 Technological resources**

Dryco has recently implemented a new enterprise resource planning (ERP) system. This system will soon be linked to its website allowing customers access to an online portal. This ERP system will also improve inventory-carrying costs by improving Dryco’s inventory turns. This system offers Dryco an advantage over

many of their competitors by allowing customers to access their online accounts. Customers will be able to check invoices, receive quotes and place orders through this portal. Competitors have access to the same technology. A new ERP system, however, requires over a year to install and implement, giving Dryco a big head start.

## 4.3 ORGANIZATIONAL STRUCTURE

**Figure 4.1:** Organizational chart for Dryco Building Supplies (March 2013)



**Source: Author**

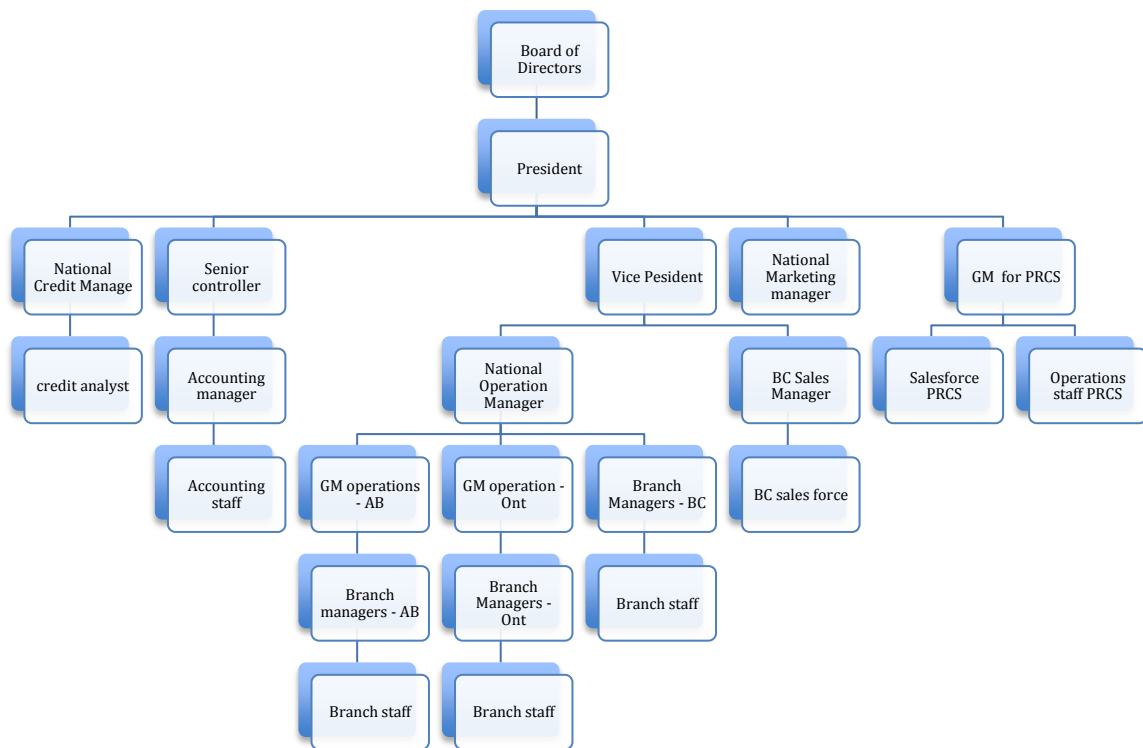
This sub-section looks at Dryco's current organizational structure and determines if this structure fits with a new business line. Figure 4.1 shows Dryco's current organizational structure, which has been stable for the last 5 years. While Dryco's organizational structure appears very hierarchical, communication within the company frequently occurs between the various levels. For example, while The Alberta and Ontario GM's officially report to Dan Mauro, the National Operation Manager, they often go directly to the Vice president or President of the company for advice or to present ideas. This flexibility within the organizational structure allows Dryco to react quickly to threats or opportunities. Using organizational theory terminology, Dryco acts much more like an entrepreneurial organization than a regulatory one (Wexler, 2012). Dryco has been eager to try new product lines but quick to retire them if they are seen as unprofitable. This behavior bodes well for a company looking to start a new business in a different industry.

The personality of Dryco's leadership highly influences Dryco's strategy. Jim Ritchie's entrepreneurial spirit grew a small manufacturing company into the leading drywall compound manufacturer in Western Canada. He continues to focus on growth and new opportunities. Bruno Mauro and his family were Dryco's co-founders are driven to grow the business. Darren Joyce started with Dryco when there were only 2 branches and has helped to oversee the company's growth across the nation. It is reasonable to suggest, however, that under different leadership Dryco may take on a more regulatory worldview due to its size and structure.

### 4.3.1 Organizational structure including PRCS

The current organizational structure allows operations to operate independently from the accounting, credit and marketing department. This structure allows Dryco to use these departments to support a new business, lowering entry costs. The structure of the two businesses combined is shown in figure 4.2.

**Figure 4.2:** *Organizational Chart for Dryco and PRCS (proposed)*



Source: Author

As seen above, the addition of the PRCS business easily fits into the current Dryco organizational structure. This structure allows PRCS to use the services of the accounting, marketing and credit department without incurring additional costs.

#### **4.4 HOW DOES PRCS ADD VALUE IN THIS NEW INDUSTRY?**

This sub-section looks at how Dryco can add value (i.e. generate revenue) with the PRCS business unit. Figure 4.3 shows the value chain for the PRCS business unit. A **value chain** is a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market (Porter, 1996).

***Figure 4.3: Value Chain for PRCS business***



**Source: Author**

##### **4.4.1 Maximize value from PRCS value chain**

PRCS must develop a competitive advantage in order to grow above the industry average. This can be done by differentiation of through low cost advantage

(Boardman, Shapiro and Vining 2004). This sub-section looks at how PRCS can create value in each link of the value chain.

#### **4.4.1.1 Maximize value from suppliers**

Partnering with vendors is the first link in the PRCS value chain. PRCS can only differentiate on products in the windows and door sector. It is important for PRCS to establish a relationship with a supplier in this sector that offers top quality products. PRCS should seek an exclusive distributorship from their chosen vendor. This would allow PRCS to maintain competitive advantage through differentiation. A strategic partner is less important in roofing and cementitious siding, since there are few Canadian suppliers to choose from. PRCS could attempt to import new lines from the U.S. or overseas to differentiate on these products. This is a risky strategy, as Canadian customers may not accept these products.

#### **4.4.1.2 Maximize value from inventory management**

PRCS can obtain a competitive advantage in this link of the value chain by minimizing costs. The new ERP system already implemented by Dryco can help on this front. This system allows PRCS to focus on just in time inventory on some products. For some product lines, specifically roofing, this is not possible due to volume discounts offered by suppliers.

#### **4.4.2.3 Maximize value from sales and marketing**

PRCS can achieve competitive advantage in sales and marketing by differentiating on service. PRCS would have sales staff focused on professional renovators instead of builders or contractors. The professional renovator customer segment is underserved by many of the current distributors. PRCS will be able to



use Dryco's marketing department at little to no cost. PRCS can use these resources to develop a reputation as service leaders for the customers they are targeting.

#### **4.4.2.4 Maximize value from delivery of products to site**

The GSD industry differentiates on delivery service. This has forced Dryco's operational staff to perform efficiently and focus on customer service. PRCS can capitalize on this culture of customer service by extending it to the professional renovator customer segment. This segment is accustomed to dealing with companies such as The Home Depot and Lowes. These big box stores traditionally do not offer high levels of delivery service. This allows PRCS to differentiate with their delivery services.

PRCS can also achieve competitive advantage in this link of the value chain through low cost. PRCS can save on equipment and personnel costs by using Dryco's existing operational resources. This should give PRCS a lower cost per delivery than any competitor.

#### **4.4.2.5 Maximize value from administrative services**

The majority of the customer segment targeted by PRCS will purchase material on account. Customers will be quoted for day to day and job pricing. Customers require quotes quickly and want invoice prices to match these quotes. PRCS can use Dryco's new ERP system to manage all accounting functions. This system is linked to an online portal that allows customers to check invoices or pricing online. This service can differentiate PRCS from their competition without needing to spend money on an expensive ERP system of their own.

## **4.5 SUMMARY OF DRYCO'S INTERNAL CHARACTERISTICS**

### **4.5.1 Summary of Dryco's resources**

This section began with a look at Dryco's current resources. Dryco has a strong balance sheet containing very little long-term debt and a significant amount of available credit. Dryco has a fleet of trucks and forklifts that can be used for loading and unloading a new line of building materials. The management team is stable and has extensive experience in the building materials sector. Dryco has an abundance of young talent, looking for new opportunities for advancement, within their middle management ranks. They have members of their sales team that have already developed connections in the roofing industry. Dryco has a centralized accounting staff that can absorb the accounting needs of a new business at little cost. Finally, Dryco has a new ERP system that offers customers services no competitor currently can.

### **4.5.2 Summary of Dryco's organizational structure**

Dryco's organizational structure promotes an entrepreneurial attitude and a new business easily fits into this structure. The accounting staff can easily handle the requirements of the new business and the same can be said for the credit and marketing department.

### **4.5.3 How can Dryco add value with PRCS? – Economies of scope!**

Dryco can use economies of scope between its current business and PRCS to create value within this new business. Dryco currently has an abundance of resources that

can be used to enter a new business. They also have an organizational structure that will support PRCS without incurring additional costs. Dryco can use their existing resources to help obtain low cost advantage in all links of the PRCS value chain. By obtaining competitive advantage PRCS can achieve growth beyond industry average. The next section compares Dryco's current strategy for growth to the proposed strategy of opening PRCS.

## **5: DRYCO'S STRATEGY FOR GROWTH: TIME FOR A CHANGE?**

### **5.1 PURPOSE OF THIS SECTION**

This section incorporates the analysis from sections 2, 3 and 4 to formulate a proposal for Dryco strategy going forward. The first sub-section looks at Dryco's current strategy for growth. The second sub-section looks at the proposed strategy for growth. The final section looks at the expected performance from the proposed strategy comparing it to recent results of the company.

### **5.2 DRYCO CURRENT STRATEGY FOR GROWTH**

Dryco has employed different strategies for growth in each region. This sub-section examines these strategies and their potential to generate continued growth.

#### **5.2.1 Dryco's growth strategy in B.C. – open new locations to serve growing markets**

Dryco was founded in 1973 as a drywall supply yard focused on residential construction. From the beginning, Dryco differentiated themselves from competitors with high levels of customer service. Dryco expanded from that 1 location in Vancouver to 9 locations nationwide over the last 40 years. Dryco's expansion in the lower mainland was achieved by opening new locations in growing areas. The Surrey location opened in 1982, Langley in 1993 and finally Mission opened in 2004. All three of these branches were opened at time of high growth in new construction. Thus, Dryco was able to transfer existing clientele to these new locations. This strategy gave the new branches enough initial revenue to cover operation costs.

### **5.2.2 Dryco's growth strategy in Alberta and Ontario – acquisition**

Dryco used a different strategy in order to expand into other provinces. Calgary is the only 1 out of the 5 branches operating in Alberta and Ontario that was started as a greenfield operation. Dryco acquired existing GSDs for the other 4 locations. This strategy was used due to a new GSD's high operating costs combined with a long sales cycle for customer acquisition. Dryco kept the management and operational staff of most of their acquisitions. This strategy benefited Dryco by allowing them to enter new markets in a short time frame. This strategy's downside is the significant capital outlay required.

### **5.2.3 Dryco's growth strategy during the last decade – grow with the market**

Dryco has relied heavily on growth in new construction to fuel revenue growth over the last decade. While effective from 2000 to 2008, the recession of the late 2000's saw revenues shrink for the first time in years. Additionally, in 2007 Dryco acquired 2 new GSD's, one in Yarrow, B.C. and one in Brampton, Ontario. The recession forced both operations to close within 3 years. Under Jim Ritchie's guidance Dryco has also attempted to grow by expanding into new product lines. A lack of commitment to these products by most managers and salesmen has led to mixed results from this strategy.

### **5.2.4 Growing with current strategy**

Dryco's owners are hesitant to acquire new locations with the failure of the 2 latest acquisitions. A projected plateau in new construction makes the strategy of growing with the market unattractive. This leaves Dryco with the option of

expanding into new product lines. In order for this to be successful there needs to be buy in from all levels of the organization. This has not been the case in the past. Operations and sales staff prefer to focus on their existing product lines and customer base.

An alternative strategy is to push for increased market share in the GSD industry. This strategy will be difficult to accomplish without competing on price. Growth would be short-term as competitors would quickly match lower prices. This strategy would result in flat revenues and lower margins.

### **5.3 DRYCO'S PROPOSED GROWTH STRATEGY – OPENING PRCS**

The client believes Dryco needs to open a new business line in order to achieve significant growth going forward. The proposed new business focuses on offering windows, doors, roofing and siding to professional renovators. This business will be co-located with existing Dryco locations. Chapter 3 looked at the attractiveness of this new industry. High rivalry, supplier power and barriers to entry make this industry somewhat unattractive. Section 4, however, showed that economies of scope between the two businesses make entry more attractive. Dryco's existing infrastructure allows them to enter this industry without having to spend a significant amount on new equipment or locations. Dryco's resources also reduce fixed administration costs of accounting, credit and marketing. Dryco must continue to focus on high levels of customer service to differentiate itself from competitors in this new industry. Dryco's culture and operational resources facilitate this.

The client wishes to operate this business as a separate entity from the rest of Dryco. An experienced General Manager should be hired to run this division. This position can be filled externally or internally. Dryco, however, has an abundance of young talent, which may be tempted to leave if not offered opportunities for advancement. PRCS's GM should have complete profit and loss responsibility and autonomy in selecting his team. This places the success or failure of this business on his shoulders.

PRCS will focus on a completely new customer base and offer a completely different product line. All revenues from PRCS can be treated as revenue growth for Dryco. This strategy, if successful, gives Dryco a blueprint for future expansions into new businesses.

## **5.4 PERFORMANCE USING PROPOSED STRATEGY**

This sub-section focuses on the break-even revenues for PRCS in year one. These estimates look at the option of 2 or 3 PRCS locations. For the purpose of this analysis we assume zero opportunity costs for the use of the accounting, marketing and credit functions. While not completely accurate, this assumption makes estimates of PRCS' revenues needed to break even easier to calculate.

### **5.4.1 Financial analysis for 2 PRCS locations**

Figure 5.1 looks at the revenue needed for PRCS to break even while operating 2 locations with margins of 20%, 25% and 15%. The two locations would be Barrie and Calgary as they already carry roofing.

**Figure 5.1:** *PRCS pro forma income statement for 2 locations (all figures in 1000's)*

Margin	20%	25%	15%
Net sales	\$2,040	\$1,560	\$3,440
Cost of goods sold	\$1,632	\$1,170	\$2,924
<b><u>Gross profit</u></b>	<b><u>\$408</u></b>	<b><u>\$390</u></b>	<b><u>\$516</u></b>
<b><u>Total operating expenses</u></b>	<b><u>\$392</u></b>	<b><u>\$371</u></b>	<b><u>\$481</u></b>
Gm Salary	\$125	\$125	\$125
Other wages	\$150	\$150	\$150
Delivery & other expenses	\$102	\$78	\$172
<b><u>Interest expense</u></b>	<b><u>\$15</u></b>	<b><u>\$18</u></b>	<b><u>\$34</u></b>
<b><u>Income bef. taxes</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>
Tax Provisions	\$0	\$0	\$0
<b><u>Net income</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>

**Source: Author**

The balance sheets accompanying all income statement are found in appendix figure 5.1. Operating expenses are based on the following criteria: A General Manager with a salary of \$125,000/annum. One salesman, with a \$75,000 salary, would be needed per location. Delivery and other costs are calculated at 5% of total sales. PRCS would use Dryco's operational staff and equipment for its' first year of operations. Dryco would bill PRCS for these services, estimated here to be 5% of sales. Interest expense is based on a 5% of total credit needed. Total credit needed is calculated as **NFO** (cash needed for operations + inventory + accounts receivable-accounts payable-accrued expenses) – **Working capital** (Total equity + long term assets – long-term debt) (Abascal, 2004). Estimates of accounts



receivable and accounts payable are based on Dryco's current policies of 30 days for each. Inventory is based on turns of 6 per year. Turns are lower than Dryco's current policy but this figure was chosen due to the need for large stock purchases in roofing and siding. Equity, fixed assets and long term debt are all set a zero.

#### 5.4.2 Financial analysis based on 3 locations

Figure 5.2 shows the pro-forma income statement for PRCS if the business opened a 3rd location in B.C. or Edmonton

**Figure 5.2:** PRCS Pro Forma income statement for 3 locations (all figures in 1000's)

Margin	20%	25%	15%
Net sales	\$2,590	\$1,890	\$4,140
Cost of goods sold	\$2,072	\$1,418	\$3,519
<b><u>Gross profit</u></b>	<b><u>\$518</u></b>	<b><u>\$473</u></b>	<b><u>\$621</u></b>
<b><u>Total operating expenses</u></b>	<b><u>\$499</u></b>	<b><u>\$458</u></b>	<b><u>\$589</u></b>
Gm Salary	\$125	\$125	\$125
Other wages	\$225	\$225	\$225
Delivery & other expenses	\$130	\$95	\$207
<b><u>Interest expense</u></b>	<b><u>\$19</u></b>	<b><u>\$14</u></b>	<b><u>\$32</u></b>
<b><u>Income bef. taxes</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>
Tax Provisions	\$0	\$0	\$0
<b><u>Net income</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>

**Source: Author**

The extra salesmen salary and increased delivery costs in this scenario increase costs by \$82,000 to \$140,000. Sales per location required to break even are lower than in the first scenario, implying that there are economies of scale to be capitalized upon. This suggests the 3-branch option is preferable to the 2-branch

one. It is reasonable to assume that opening a 4<sup>th</sup> branch would capitalize on these economies of scale even more. Dryco, however, has limited excess capacity. If new warehouse space and equipment were needed for PRCS this new business would not make economic sense.

## **5.5 EXPECTED SALES FOR PRCS**

The previous section shows the required sales for this new venture to break even. This sub-section looks at realistic revenue targets for the first year from each line.

### **5.5.1 Expected sales from windows and doors**

Kohler Windows and Doors, Dryco's window supplier, estimates the average revenue from a window package for a home renovation to be \$15,000. Kohler has informed Jim Ritchie that each location showcasing their product should sell approximately \$2 million per year. PRCS would expect 6 million in sales from windows and doors if this figure is accurate. Dryco management should be skeptical of this figure due to the source being a manufacturer trying to secure a distributor.

Using the \$15,000 per window package as a baseline, 3 locations each selling 4 window packages per month would generate over \$2 million in revenue. This figure will be used as a conservative estimate of window and door sales in the first year. According to Kohler, Dryco should be able to achieve margins of approximately 20-25% on these products. This figure falls within the range used for the estimates in figures 5.1 and 5.2

### **5.5.2 Expected sales from roofing**

Dryco already distributes roofing in two locations, making estimating expected sales for this line easier. Dryco's roofing sales for the 2012 fiscal year amounted to just under \$1 million companywide (Appendix figure 5.3). Sales to existing roofing customers, however, should be excluded from any estimates for the PRCS business. This figure does offer a guideline of what can be reasonably expected from a small roofing distributor.

Dryco is relatively new to the roofing industry and currently has a small market share. This leaves significant room for growth within this product line. Thus, \$1 million in new revenue from roofing is an achievable goal. Margins from roofing are in the 15-20% range, within the range used for estimates in figures 5.1 and 5.2. Targeting the professional renovator may allow PRCS to achieve higher margins due to the smaller size of these customers.

### **5.5.3 Expected revenue from siding**

Dryco has no experience and no supplier to partner with in this market. This makes revenue predictions for this product line difficult. Depending on style and colour, the selling price per square foot of the James Hardie Siding product is between \$1.25 and 1.60 per square foot. Dryco is reluctant to take a large inventory position, forcing them to buy the product from another distributor. This product line has more competitors than the other products PRCS would distribute. There are only two manufacturers, giving PRCS an undifferentiated product from their competitors. Deliveries of this product are dropped in front of the site and require no specialized equipment. This makes differentiation on service difficult. These

factors make this product line the most difficult to enter and likely the one with lowest revenues.

If each 3 PRCS locations sold 7000 square feet per month, about \$10,000 worth of product, annual revenue from this product would be \$360,000. The figure of 7000 square feet would represent enough products to complete a complete renovation on 2-3 homes.

#### 5.5.4 Total expected revenue for PRCS in year one

Combining the estimates from the 3 previous sub-sections give us revenue in year 1 of approximately \$3,360,000. Figure 5.3 shows expected profit using the margins of 20%, 25% and 15%

**Figure 5.3:** PRCS pro forma income statement based on expected revenues (all figures in 1000's)

Margin	20%	25%	15%
Net sales	\$3,360	\$3,360	\$3,360
Cost of goods sold	\$2,688	\$2,520	\$2,856
<b><u>Gross profit</u></b>	<b><u>\$672</u></b>	<b><u>\$840</u></b>	<b><u>\$504</u></b>
<b><u>Total operating expenses</u></b>	<b><u>\$543</u></b>	<b><u>\$543</u></b>	<b><u>\$544</u></b>
Gm Salary	\$125	\$125	\$125
Other wages	\$225	\$225	\$225
Delivery & other expenses	\$168	\$168	\$168
<b><u>Interest expense</u></b>	<b><u>\$25</u></b>	<b><u>\$25</u></b>	<b><u>\$26</u></b>
<b><u>Income bef. taxes</u></b>	<b><u>\$104</u></b>	<b><u>\$273</u></b>	<b><u>-\$66</u></b>
Tax Provisions	\$21	\$54	\$0
<b><u>Net income</u></b>	<b><u>\$83</u></b>	<b><u>\$219</u></b>	<b><u>-\$66</u></b>

Source: Author

## **5.6 SUMMARY OF DRYCO'S STRATEGIES – ECONOMIES OF SCOPE MAKE PRCS A GOOD STRATEGY FOR GROWTH**

Dryco current strategy for growth is to grow within the GSD industry by increasing market share or through expansion. While this strategy was successful during the company's first 30 years the last 10 have seen growth stagnate. New construction levels are projected to plateau for the next few years. Dryco has a large market share position in most of its operating regions. With their current strategy, Dryco's chances for growth are slim. The proposed strategy of opening a new business, PRCS, offers Dryco the opportunity to enter a new sector of the construction industry. Estimated first year revenue is 3.36 million dollars, approximately 4% of Dryco's 2012 revenues. PRCS would be profitable on gross margins of 20% or higher at this level of revenue. PRCS has no market share, offering significant room for growth. With their existing infrastructure, Dryco could enter this new business without taking on significant financial risk. If PRCS proves to be unsuccessful, Dryco can exit quickly.

It should be highlighted, once again, that this proposed strategy relies on economies of scope between Dryco and PRCS. If PRCS was forced to fully support operations, accounting and marketing costs, opening this business would not be feasible. The next section will perform an option analysis of this and other options for Dryco.

## **6: STRATEGIC OPTION ANALYSIS FOR DRYCO BUILDING SUPPLIES**

### **6.1 PURPOSE OF THIS SECTION**

This section analyzes Dryco Building Supply's options for growth. The information presented in the previous 5 sections is used for this analysis. This section is split into 8 sub sections. The first sub-section identifies Dryco's strategic opportunities. The second sub-section looks at Dryco's best case, worst case and most likely scenarios. The third sub-section outlines the strategic goals of Dryco management. The fourth sub-section analyzes each of Dryco's strategic opportunities. The fifth sub-section looks at the likelihood of each alternative meeting the strategic goals of the company. The sixth sub-section weights these probabilities based on importance to the company. The next sub-section looks at the effects the best or worst-case scenario would have on the chosen alternative. The final section gives a recommendation and implementation plan.

### **6.2 DRYCO'S STRATEGIC ALTERNATIVES**

#### **6.2.1 Maintain the status quo**

Maintaining the status quo would see Dryco stay in their current industry, and operate in their current manner. Dryco would rely on new construction and increasing their market share within the GSD industry for revenue growth. Dryco would continue to differentiate with high levels of service. Dryco could also obtain competitive advantage by reducing costs through improved efficiency

### **6.2.2 Offer new products lines under the Dryco banner**

Dryco could expand their product offerings using Dryco's existing sales and operational staff. Dryco has attempted this numerous times over the last 7 years with various levels of success. This strategy could increase revenue by expanding Dryco's economies of scope. Dryco may promote or hire staff to oversee the sales of these new products.

### **6.2.3 Open new business focused on professional renovators (PRCS)**

Sections 3 to 5 examined the idea of opening a new business focused on professional renovators called PRCS. Dryco would run the new business as a separate profit center, managed by an individual responsible for PRCS' profit and loss. Dryco's president is interested in this business in order to diversify their customer base and minimize Dryco's exposure to a slowdown in new construction.

### **6.2.4 Expand to new regions**

Dryco could expand to new geographic regions through acquisition or the opening of greenfield locations. These locations could be within Canada or the U.S, and could be managed by either existing Dryco staff or new hires.

## **6.3 DRYCO'S POSSIBLE FUTURE SCENARIOS**

### **6.3.1 Best-case scenario**

Dryco's best-case scenario is for new construction to return to the growth levels of the mid 2000's in western Canada and Ontario. This growth, combined with limited entry into the GSD industry, would help increase both revenue and

margins. Dryco could then expand existing locations by adding structures, equipment and staff without taking on the risk of entering new product lines or regions.

This scenario is unlikely to happen since sales in the Canadian housing market appear to be cooling. Expensive land prices in western Canada and Ontario make acquiring large parcels of land unattractive for developers. The combination of these factors makes the chances of a new construction boom slim.

### **6.3.2 Worst-case scenario**

Dryco's worst-case scenario would be for the new construction market in Canada to experience a downturn similar to the one that occurred in the U.S. in 2008. Revenues and profits would shrink, forcing Dryco to close locations and liquidate some of their assets. Many GSD's in the U. S. were unable to survive the economic downturn in 2008. Dryco, while presently financially stable, could face the possibility of shutting down the business if the recession was severe enough. While not likely, this scenario is possible. There continues to be speculation about a housing bubble in both Vancouver and Toronto. If these bubbles burst the consequences for Dryco would be severe.

### **6.3.3 Most likely scenario**

The most likely scenario is that Canada's housing market achieves a soft landing with new construction experiencing a slight decline. Dryco would be able to continue operation as usual without having to dramatically reduce staff or close any locations.



While housing starts are down in some regions, most analysts expect this soft landing to occur. Dryco should assume this scenario when planning strategic initiatives.

## 6.4 EVALUATION OF DRYCO'S GOALS

Dryco's goals are used to analyze the strategic alternatives described in subsection 6.2. These goals were assembled with input from Dryco's National Operations Manager Dan Mauro. Mr. Mauro was chosen because he represents both the management team and the ownership group. The goals and their definitions are listed below.

1. **Short term profitability:** revenues exceeding costs over the next fiscal year
2. **Long term profitability:** revenues exceeding costs over the next 5 fiscal years
3. **Revenue growth:** companywide revenues growing year over year
4. **Risk management:** decrease chance of significant financial losses
5. **Employee retention:** retain and developing current core staff
6. **Increasing shareholder value:** increasing the overall worth of the company

### 6.4.1 Weighting of Dryco's goals

Figure 6.1 shows Mr. Mauro's weighting of Dryco's goals. A brief explanation is given for each goal to explain the weighting given.

**Figure 6.1:** Dryco Building Supply's goals with relevant importance

<u>Goals</u>	<u>Weighting</u>	<u>Reasons</u>
Short term profitability	25%	No reason given
Long term profitability	20%	No reason given
Revenue Growth	20%	Easiest way to increase profits in GSD industry
Risk Management	15%	Risk Adverse ownership group. Weighs heavily in decisions to invest in new projects
Employee retention and Development	15%	Important for revenue growth and long term profitability
Increasing Shareholder value	5%	One majority owner not looking to sell, therefore not driving factor in decision making

**Source: Author**

## **6.5 ANALYSIS OF DRYCO'S STRATEGIC ALTERNATIVES ASSUMING THE MOST LIKELY FUTURE SCENARIO**

### **6.5.1 Does maintaining the status quo satisfy Dryco's goals?**

Dryco would satisfy at least two of their goals by maintaining the status quo. This strategy would not require any investment in new product, equipment or personnel. This would satisfy the goal of short-term profitability.

With no new investment in product, personnel, locations or equipment, Dryco would not be taking on any additional financial risk. Thus, this strategy also satisfy's the goal of risk management.

Dryco's other goals would not be satisfied, however, if this strategy were chosen. It is unlikely Dryco would experience much revenue growth by maintaining

the status quo unless section 6.3.1's best-case scenario, a new construction boom, occurred. This strategy also makes it unlikely that Dryco will be able to offer much in terms of employee development or retention. In terms of shareholder value, if the company cannot achieve revenue growth they will be unable to increase long-term profits. Dryco is a private company, thus, their value will generally be determined by a multiple of its average EBITA. If EBITA is flat then so is the company's value.

### **6.5.2 Does offering new product lines under existing banner satisfy Dryco's goals?**

If Dryco were to offer new product lines under their existing banner short-term profitability may be negatively impacted. It would take at least 6 months to generate significant revenue from these new products. Meanwhile, increased carrying costs of extra inventory and the possibility of needing to add sales positions would immediately increase costs.

Long-term profitability will depend on the success of the new product offering and will be reflected by increasing revenues. If Dryco is able to successfully add new product lines, they should be able to add to both their revenues and long-term profitability. In the past Dryco has had a difficult time adding new product lines. This was due to the existing sales and operational staff reluctance to devote resources to these products. This was particularly noted when the products were not ones that could be sold to Dryco's existing customer base.

Adding new product lines increases Dryco's financial risk due to the commitment to higher inventory levels and possibly more staff. As long as the products are easy to liquidate, however, there are few sunk costs. As there may be new positions created to promote these new product lines the goal of employee development could be satisfied. This is only relevant if the new positions are seen as promotions over employees' current ones. The addition of new product lines also offers the possibility of increasing Dryco shareholder value, due to the potential of increasing the company's long-term profitability.

### **6.5.3 Does opening a new business focused on professional renovators (PRCS) satisfy Dryco's goals?**

If Dryco were to open a new business focused on professional renovators the goal of short-term profitability may not be satisfied. This new business will force Dryco to incur some start up costs, mainly the addition of new staff. If sales are not generated quickly the company's first year may be unprofitable. Section 5 calculates this new business requires would generate approximately \$3.5 million in sales. At margins of 20% or higher this covers costs, but does not contribute much to Dryco's bottom line in the first year.

PRCS would have potential for significant revenue and long-term profitability growth since this business would be targeting an untapped customer base. This also allows potential for a significant increase to shareholder value if PRCS were to succeed.

This new business would require dedicated staff; therefore it may present opportunities for Dryco staff, both short and long-term. Additionally, due to the

growth potential, these new positions may be very attractive for managers looking for a new opportunity. The startup cost of PRCS adds some financial risk to Dryco. Conversely, because PRCS diversifies Dryco's customer base, the risk of a new construction downturn is mitigated.

#### **6.5.4 Does expanding to new regions satisfy Dryco's goals?**

Expanding to new regions, especially through acquisition, would be Dryco's quickest and easiest way to increase revenues. Depending upon performances in these regions, Dryco could also significantly benefit in terms short and long-term profitability.

Expansion may also offer opportunities for existing staff to develop, or shift, within the company. Positions would be created to manage the new regions and, depending on the scope of the expansion, new upper management positions may be required.

The downside of expansion is that it would create a significant risk for Dryco. As mentioned in Chapter 4, the last 2 Dryco acquisitions were unsuccessful and cost Dryco a considerable amount of money. Although Dryco is currently financially stable, if they were to aggressively expand they would likely need to take on long-term debt. Additionally, by staying in the GSD industry Dryco would remain exposed to new construction downturns. If Dryco were to employ this strategy and sub-section 6.3.2's worst-case scenario occurred the consequences would be dire.

## 6.6 STRATEGIC OPTION EVALUATION FOR DRYCO ASSUMING THE MOST LIKELY FUTURE SCENARIO

This sub-section evaluates the likelihood that each strategic option will meet the goals set by Dryco management. Figure 6.2 was designed by Vining and Meredith (2000) in order to facilitate a high level understanding of the probability associated with each strategic option meeting the outcome desired by the company. The expected outcome is measured by a low-medium or high ranking. This analysis is done assuming the most likely future scenario described in sub-section 6.3.3.

**Figure 6.2:** Dryco's strategic option's compatibility to management goals

<b>Goals</b>	<b>Strategic Options</b>				
		<i>Status quo</i>	<i>New products under Dryco banner</i>	<i>New business PRCS</i>	<i>Expand to new locations</i>
	<i>Short term profitability</i>	<i>High</i>	<i>Med</i>	<i>Low</i>	<i>Med</i>
	<i>Long term profitability</i>	<i>Med</i>	<i>Med</i>	<i>High</i>	<i>Med</i>
	<i>Revenue growth</i>	<i>Low</i>	<i>Med</i>	<i>High</i>	<i>High</i>
	<i>Risk management</i>	<i>High</i>	<i>High</i>	<i>Med</i>	<i>Low</i>
	<i>Employee development</i>	<i>Low</i>	<i>Med</i>	<i>High</i>	<i>High</i>
	<i>Increase shareholder value</i>	<i>Low</i>	<i>Med</i>	<i>High</i>	<i>Med</i>

**Source:** Vining & Meredith (2000) adapted by author

Figure 6.2 shows that opening a new business has a high expected outcome for 4 out of 6 of Dryco's management's goals. The goal of short-term profitability is the only one not met. Expanding to new locations is rated high for 2 of the 6 goals but scores low in terms of risk management. Selling new products under the Dryco banner appears the safest option, as its expected outcome is medium for 5 of 6 goals, with risk management scoring high. The status quo has the widest range of expected outcomes with the goals of short-term profitability and risk management scoring high but with poor expected outcomes in 3 of the other 4 categories.

Each option has strong and weak areas in relation to Dryco's goals. Since the matrix in figure 6.2 does not take into account the weighting of those goals, it cannot be used to determine a course of action for Dryco.

## **6.7 MULTI GOAL EVALUATION FOR DRYCO ASSUMING THE MOST LIKELY FUTURE SCENARIO**

This section expands on the evaluation from section 6.6, weighting each goal used in the evaluation of Dryco's options. In figure 6.3, the expected outcomes in sub-section 6.6 are each assigned a value (Low =10 Med = 20 High =30) and then multiplied by the weighted average of each goal given in sub-section 6.4. These scores are then summed in order to give a total for each option. Vining and Meredith (2000) also developed this matrix. Once again, this analysis is performed assuming the most likely future scenario described in sub-section 6.3.3.

**Figure 6.3:** Dryco's strategic option's compatibility to weighted management goals

Goals	Strategic Options									
		Status quo		New products under Dryco banner		New business PRCS		Expand to new locations		Weight
	Short term profitability	High	7.5	Med	5.0	Low	2.5	Med	5.0	25%
	Long term profitability	Med	4.0	Med	4.0	High	6.0	Med	4.0	20%
	Revenue growth	Low	2.0	Med	4.0	High	6.0	High	4.0	20%
	Risk management	High	4.5	High	4.5	Med	3.0	Low	1.5	15%
	Employee development	Low	1.5	Med	3.0	High	4.5	High	4.5	15%
	Increase shareholder value	Low	.5	Med	1.0	High	1.5	Med	1.0	5%
Totals		20		21.5		23.5		20		100%

**Source: Vining and Meredith (2000) adapted by author**

Figure 6.3 highlights that in consideration of the weightings given by Dryco's management; the company's goals are best satisfied by the option to enter a new business with a focus on professional renovators. The second best option is to offer new products under the Dryco banner. Despite ranking low on the highest weighted goal, short-term profitability, the PRCS option should still be pursued as it meets other goals on a high level.



## **6.8 EFFECT OF ALTERNATIVE FUTURE SCENARIOS ON DRYCO'S STRATEGIC DECISION**

### **6.8.1 PRCS under best-case scenario**

Dryco will have an easier time launching PRCS if new construction rebounds to 2007 levels. Most firms currently supplying the products analyzed in Section 4 heavily target the new construction market. If new construction is booming, other firms will have less time to devote to the professional renovators sector, giving PRCS an opportunity. An increase in new construction business also tends to increase margins on building products; this is simple supply and demand. As discussed in Section 5, due to high fixed costs, even a 5% increase in margin make PRCS' break-even revenue drop quickly.

### **6.8.2 PRCS under worst-case scenario**

The PRCS option would still be beneficial to Dryco under the worst-case scenario. Shielding the company against a new construction downturn is one of the reasons the idea of this new business was presented. During the U.S. construction slowdown in the late 2000's the general population shifted their focus from purchasing new homes to renovating their existing one. This focal shift helped companies, such as the Home Depot and Lowes, which focused on renovators to maintain profitability. Companies that focused sales on new construction saw revenues plunge.

While the PRCS business is still attractive under the worst-case scenario, it would face some challenges. The main challenge would emerge as competitors shifted their sales focus onto professional renovators as new construction slowed.

Margins would be squeezed, increasing revenue requirements for PRCS to break even.

The Canadian housing market appears to be heading towards a soft landing. This makes the chances of either the best or worst case scenario unlikely. Dryco management, however, should weigh the possibility of both scenarios when making their decision about where to direct the company.

## **6.9 RECOMMENDATION: OPEN A NEW BUSINESS FOCUSED ON PROFESSIONAL RENOVATORS**

### **6.9.1 Conclusion and recommendation**

Dryco Building Supplies has been in the GSD industry for 40 years. During that period they have achieved growth through expansion of locations and growth in the Canadian new construction industry. Dryco needs to investigate new avenues for growth as the GSD market is now saturated and new construction is slowing. Dryco can utilize economies of scope in order to enter a new industry focused on professional renovators. Dryco can enter this industry at a much lower cost than others due to their existing infrastructure. The new business will give Dryco opportunity for revenue growth and long-term profits, in turn increasing shareholder value. Additionally, Dryco's problem of development and retention of staff could be addressed by adding a new business. While this new operation could have a negative impact on short-term profitability, other benefits outweigh this negative factor.

If Dryco's management determines that the cost and risk of opening this new business are too high the best alternative is to add new product lines under the

Dryco banner. The risk of this strategy is that staff will not commit adequate time or resources to these new products. This has been a problem in the past and if Dryco were to pursue this strategy this problem needs to be addressed. Dryco can address staff's reluctance to sell new products with educational product knowledge seminars. Introducing incentive programs for staff to promote new products may also increase employee buy-in.

### 6.9.2 Implementation plan for PRCS

In order for Dryco to be successful in their new business, a detailed implementation plan needs to be created. This sub-section will outline an implementation plan that Dryco may or may not choose to use. Figure 6.4 shows the steps of the plan.

**Figure 6.4:** *Implementation plan for PRCS*



**Source: Author**

#### **6.9.2.1 Hire general manager for PRCS**

In order for PRCS to be successful, the business will require the right leader. Dryco needs to decide whether to hire a GM for PRCS from within or externally. Ideally the individual should have some experience within the building supply industry. Knowledge and contacts within the exterior renovation industry would be an asset as well, although these could be developed over time. This candidate must have proven management skills. PRCS will need to be run extremely lean, so a proven track record as a low cost operator is a must. Other assets Dryco should look for in this hire include: experience in growing a start up, proven ability to develop and train staff and experience in sales and marketing.

#### **6.9.2.2 Determine Dryco/PRCS co-locations**

Once a manager for PRCS is in place, Dryco needs to determine which of its current locations would be best suited to the establishment of a PRCS business.

Important criteria include:

1. Local market conditions (i.e. is there an abundance of older homes in need of renovation in the area?)
2. Available excess yard space for materials.
3. Available excess capacity for delivery equipment & personnel.
4. Proximity to suppliers, in order to reduce lead times and inbound freight costs.

#### **6.9.2.3 Access product needs and develop relationships with suppliers**

Once Dryco has determined ideal PRCS locations and logistics they must examine inventory and suppliers. Specifically, the inventory levels to carry for each product and which suppliers they should partner with. The supplier should be

chosen based on quality of product, price offered, lead-time and availability. For cementitious siding specifically, this may mean that Dryco will need to purchase off another distributor since numerous colours and styles must be stocked.

#### **6.9.2.4 Develop marketing strategy**

This development of a marketing strategy is the most important part of the implementation plan. Dryco will need to determine how it will send its sales force to market. They will need to decide whether to call on contractors only or include homeowners. Radio and print advertising will need to be discussed. An effective marketing strategy will convince customers to buy from PRCS instead of their current building supplier. Dryco's marketing department must formulate their strategy before they take the next step of the implementation.

#### **6.9.2.5 Hire a sales force and go to market**

Dryco already has two existing salesmen focused on the new construction roofing market. They will need to be determined whether or not to transfer these salesmen to PRCS. Dryco may need to hire additional salesmen depending on how many PRCS location are opened and where they are located. Inside sales support may also be required to co-ordinate orders that are taken by PRCS but shipped using Dryco's equipment. PRCS will require an effective sales force that is able to generate and close on new leads. This differs from Dryco's existing sales force that is more focused on customer maintenance.

### 6.9.3 Four fundamentals of implementation and execution of strategy

Once this plan is in place Dryco needs to take the following actions to ensure successful implementation (Irwin 2011).

1. Avoid common implementation mistakes.
2. Reach out to stakeholders.
3. Measure progress in the strategic plan.
4. Monitor the strategic plan

#### 6.9.3.1 Avoid common implementation mistakes

A new business presents a significant amount of risk to Dryco. In order to minimize this risk they need to watch out for the following mistakes within this company (Irwin, 2011):

1. **Just saying no.** Management ends up discarding the strategic plan, choosing instead to make intuitive decisions that clash with accepted strategic objectives. The result is confusion throughout the ranks of employees.
2. **Lack of communication.** The strategic plan is not communicated to front-line employees, who are therefore working in the dark.
3. **Losing sight.** Managers are so tied up in day-to-day operating problems that they lose sight of the long-term strategic goals.

4. **Business as usual.** Once the strategic plan has been drawn up, managers simply carry on as before.
5. **Wimping out.** Management recoils from making the tough choices that the strategic plan may call for.
6. **The wrong scoreboard.** Managers measure what's easy, not what's important.
7. **No yardstick.** The business neglects to benchmark itself against its competitors, so it can't measure its progress against them.

#### **6.9.3.2 Reach out to stake holders**

Dryco management needs to communicate strategy clearly and effectively with all employees. This new business will require buy in from current Dryco staff in order to succeed. This is especially true in departments that will be used to support the new business. This should be extended to other stakeholders as well, including suppliers and customers. The more excitement that can be generated for PRCS the easier it will be for it to succeed.

#### **6.9.3.3 Measure the progress in the strategic plan**

Dryco can measure how well their new strategic plan is being implemented with a few key metrics. Some of these metrics are already used by Dryco, such as: gross margin, revenue and total profit. Others, however, can be equally telling about the success of the new business. Some of these include:

- number of new customers

- return on assets
- return on equity
- return on investment
- market share
- employee morale
- customer satisfaction

By monitoring these metrics Dryco can accurately gauge the success of PRCS' implementation. These metrics will also point to areas for improvement within the new business.

### 6.9.3.4 Monitor the strategic plan

It is important that PRCS' success is closely monitored. Dryco management will need to find ways to maintain focus on PRCS while continuing to manage Dryco's current operations. Figure 6.5 outlines guidelines for successful monitoring (Irwin, 2011).

**Figure 6.5:** *Guidelines for successful monitoring of PRCS implementation*

#### Challenge underlying assumptions

- While monitoring the strategic plan's progress, continue to examine its underlying assumptions, the continued validity of its strategic objectives and the influence of unanticipated events.

#### Regular updates.

- Review progress on a monthly or quarterly basis, depending on the level of activity and time frame of the strategic plan. Specific tasks should be part of relevant strategic management meetings.

#### Create a champion for every strategy and action.

- The strategy champion doesn't necessarily have to complete the actions, but must see that they get done.

#### Stay committed.

- Every strategy-related action must have a due date.

#### Conduct short-term strategy reviews

- Scheduling team "huddles" every 90 days to keep the strategic plan reviewed, reloaded and re-energised.

#### Reward success

- Find creative ways to motivate people and reward them for focusing on the strategy and vision.

**Source: Author**



#### **6.9.4 Caveats**

PRCS presents Dryco an opportunity for growth; however, the majority of revenues will still come from the core G.S.D. business. Dryco needs to retain the best and brightest minds for its core operations. The PRCS idea will garner significant attention but Dryco management cannot allow it to distract staff from their current roles. By hiring a competent GM and giving him the right tools Dryco should be able to allow PRCS to grow as its own business. It is also important for Dryco management to be quick to react. If PRCS proves to be unprofitable, management needs to exit quickly and not dwell on sunk costs. Since Bruno Mauro is Dryco's major shareholder, his desires need to be considered above all others. This evaluation offers one set of options; however, Mr. Mauro may have other short or long-term goals that differ significantly from this recommendation.

### **6.10 SUMMARY OF DRYCO'S STRATEGIC OPTIONS**

This section looked at Dryco's strategic options for growth. Four options were examined; the status quo, new products under the Dryco banner, new business (PRCS) and expanding to new locations. Dryco management listed the company's goals with weighted relative importance. We then used a matrix to analyze the attractiveness of each of these options. This matrix showed that opening the business examined in sections 3 to 5 to be Dryco's best option for growth. An implementation plan for this new business was presented. This section then looked at 4 fundamentals of successful implementation. Finally we looked at the caveats to this new business strategy.

This paper has recommended that Dryco enter a new business focused on professional renovators. This has been based on analysis of Dryco's current industry, PRCS' industry and Dryco's internal characteristics. This new business allows Dryco to capitalize on economies of scale. If Dryco is for some reason unable to use its' excess capacity to support PRCS this new business is not recommended.

# Appendices

## Appendix 4.1

### Dryco Building Supplies Balance Sheet As at Sept 30 2012 September 30 2013

#### Current Assets

Accounts Receivable-Trade	10,147,378.00
Accounts Receivable-Rebates and Sundry	3,077,284.00
Income Taxes recoverable	
Inventory	4,416,829.00
Due from affiliated company	74,971.00
Prepaid expenses and deposits	273,219.00
	<b><u>17,989,681.00</u></b>

#### Equipment

1,405,198.00

#### Goodwill

351,332.00

**19,746,211.00**

#### Liabilities and Shareholders equity

#### Current Liabilities

Bank Indebtedness	2,591,321.00
Accounts Payable and Accrued	
Liabilities	5,436,092.00
Government Remittances payable	-
Management fees payable	605,280.00
Income Taxes	4,538.00
Due to Affiliated companies, without interest	36,848.00
Due to Affiliated company, interest at current rates	1,425,000.00
Finance contract due within one year	-
	<b><u>10,099,079.00</u></b>

#### Finance Contract

-

#### Future Income Taxes

70,000.00

#### Shareholders Equity

Share Capital	275,569.00
Retained Earnings	9,329,559.00

**Appendix 5.1**  
**PRCS**  
**(2 locations) all figures**  
**in 1000's**

**Balance Sheet**

**ASSETS**

Cash	0	0	0
Acc. receivable	170	130	286.666667
Inventory	272	195	487.333333
<i>Current assets</i>	442	325	774
<i>Fixed assets, net</i>	0	140	157
<b>Total assets</b>	442	465	931

**LIABILITIES AND NET WORTH**

Accounts payable	136	97.5	243.666667
Accrued expenses	0	0	0
Bank credit	306	366.5	685.333333
Current Long T. Debt	0	0	0
<i>Current liabilities</i>	442	464	929
Long term debt	0	0	0
<i>Total liabilities</i>	442	464	929
Net worth or Equity	0	1	2
<b>Liabilities + Equity</b>	442	465	931

**PRCS (3 locations)**  
All figures in 1000's

**Balance sheet**

**ASSETS**

Cash	0	0	0
Acc. receivable	215.833	157.5	345
Inventory	345.333	236.25	586.5
<i>Current assets</i>	561.167	393.75	931.5
<i>Fixed assets, net</i>	0	0	0
<b>Total assets</b>	561.167	393.75	931.5

**LIABILITIES AND NET WORTH**

Accounts payable	172.667	118.125	293.25
Accrued expenses	0	0	0
Bank credit	388.5	275.625	638.25
Current Long T. Debt	0	0	0
<i>Current liabilities</i>	561.167	393.75	931.5
Long term debt	0	0	0
<i>Total liabilities</i>	561.17	393.75	931.5
Net worth or Equity	0	0	0
<b>Liabilities + Equity</b>	561.167	393.75	931.5

**PRCS Balance  
sheet  
Expected  
performance  
All figures in 1000's**

**ASSETS**

Cash	0	0	0
Acc. receivable	280	280	280
Inventory	448	420	476
<i>Current assets</i>	728	700	756
<i>Fixed assets, net</i>	0	140	157
<b>Total assets</b>	728	840	913

**LIABILITIES AND NET WORTH**

Accounts payable	224	210	238
Accrued expenses	0	0	0
Bank credit	504	358	469
<i>Current liabilities</i>	728	568	707
Long term debt	0	0	0
<i>Total liabilities</i>	728	568	707
Net worth or Equity	0	272	206
<b>Liabilities + Equity</b>	728	840	913

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